

**Testimony of the National Yogurt Association  
Before the U.S. Department of Agriculture, Agricultural Marketing Service  
On Proposals to Change the Fluid Milk Product Definition**

My name is Eric Olsen, and I am an attorney with Patton Boggs, a Washington D.C. based law firm. Before coming to Patton Boggs in 2001, I worked directly for the United States Secretary of Agriculture for seven years, including as Chief of Staff and as Counsel for Domestic Policy. On behalf of the Secretary, I was involved in Federal Milk Marketing Order reform and the Northeast Dairy Compact, among many other issues. Prior to coming to Washington D.C., as an attorney with Farmers Legal Action Group, I was involved in litigation challenging the Class I differential system on behalf of the Minnesota Milk Producers Association.

With me today is Mary Keough Ledman, who is an agricultural economist providing consultation to the dairy industry. Mary's previous public service includes employment with USDA's Federal Order 30, Glen Ellyn, Illinois, the Foreign Agricultural Service, and the National Agricultural Statistic Service in Washington, D.C. Her private sector experience includes: Manager of Dairy Economics for Kraft Foods and Director of Materials Planning for Stella Foods. For the past ten years, she has been employed by Keough Ledman Associates, Inc., a dairy economic consulting firm that provides:

- Monthly dairy product and milk price forecasting
- Economic, financial and policy analysis
- Dairy product and milk sourcing strategies
- Domestic and international market information, and
- Expert witness testimony

We appear here today on behalf of the National Yogurt Association (NYA). NYA is the national nonprofit trade association representing the producers of live and active culture ("LAC") yogurt products as well as suppliers to the yogurt industry. NYA's member companies are among the largest yogurt manufacturers in the United States. NYA sponsors scientific research regarding the health benefits associated with the consumption of yogurt with LAC and serves as an information resource to the American public about these attributes.

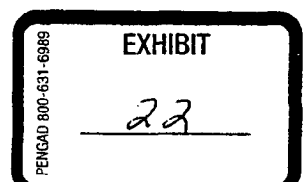
In our testimony today, we will first provide an overview of the classification system and the application of the concepts of form and use. We will then argue that yogurt-containing products that happen to be drinkable ("yogurt containing products") are food products that should be classified as Class II, and we will conclude by arguing that dairy producers should focus on expanding the market for their products, not creating incentives for food manufacturers to use non-dairy ingredients.

### **Overview of Current Classification System**

The Agricultural Marketing Agreement Act requires that milk be classified "in accordance with the form in which or the purpose for which it is used."<sup>1</sup> AMS rulemakings over the years discuss

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<sup>1</sup> 7 U.S.C. § 608c (5)(a).



the application of the concepts of form and use to the fluid milk product definition and classification system.

The current regulations provide that “fluid milk product means any milk products in fluid or frozen form containing less than 9 percent butterfat that are intended to be used as beverages...”<sup>2</sup> and goes on to list examples of products that fall within the definition. The fluid milk product definition excludes, among other things, “formulas especially prepared for infant feeding or dietary use (meal replacement) that are packaged in hermetically-sealed containers, any product that contains by weight less than 6.5 percent nonfat milk solids, and whey.”<sup>3</sup>

In determining if a product should fall within the definition of a fluid milk product, and therefore be Class I, AMS has evaluated a number of factors, including but not limited to storability, shelf life, serving sizes, percentage of nonfat milk solids and butterfat, packaging, and the location at which products are processed and the area over which they are distributed. AMS has also looked at issues like health requirements, price elasticity compared to fluid milk and whether a product is a surplus or balancing use of milk.

While these and other factors have been utilized, the fundamental concept that AMS has applied in defining Class I products is that dairy products that “compete with, or substitute for” fluid milk should be classified as Class I.<sup>4</sup> Simply put, products that compete for consumers with fluid milk should be priced like fluid milk.

For example, flavored milk, flavored milk drinks, and buttermilk were included as Class I in 1945 because “[t]hese products are disposed of in a form and for a use more nearly similar to the form and use of fluid milk than any other milk product.”<sup>5</sup> In discussing filled milk in 1969, AMS noted that it is “mainly intended as a beverage substitute” and that it “is clearly marketed for the same use as whole milk ... and is, in fact, designed as a substitute for whole milk.”<sup>6</sup> In deciding that sterilized milk should be Class I, the 1974 decision stated that “[sterilized milk products] are generally intended for use in place of their unsterilized counterparts and are competing for the same consumers.”<sup>7</sup>

Similarly, the exclusion of products that contain less than 6.5 percent nonfat milk solids from the definition of fluid milk was established because “...fluid products containing only a minimal

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<sup>2</sup> 7 CFR § 1000.15(a).

<sup>3</sup> 7 CFR § 1000.15(b)(1).

<sup>4</sup> 58 Fed. Reg. 12634, 12658 (March 5, 1993).

<sup>5</sup> 10 Fed. Reg. 13315, 13321 (October 26, 1945).

<sup>6</sup> 34 Fed. Reg. 11811 (July 15, 1969).

<sup>7</sup> 39 Fed. Reg. 9012, 9014-9015 (March 7, 1974).

amount of nonfat milk solids are not considered as being in the competitive sphere of the traditional milk beverages.”<sup>8</sup>

In the early 1990s, AMS considered the classification of yogurt containing products, using the term liquid yogurt. Despite evidence that these products do not compete with fluid milk, that they are more price sensitive than fluid milk, and that production is done by a small number of plants and product is shipped over great distances, unlike fluid milk, AMS nevertheless classified these products as Class I, stating that they “clearly are intended to be consumed as beverages and are packaged as beverage milk products.”<sup>9</sup> Rather than focusing on product characteristics, AMS used the descriptive terms of “drinkable” and “spoonable” to identify the form and use of products. Thus, AMS decided that, “because of [its] characteristics as [a] beverage milk product,...liquid yogurt should be considered Class I.”<sup>10</sup>

As demonstrated below, we believe that these yogurt-containing products fundamentally different than fluid milk. Consumers use them as food, not as beverages, and they should be classified with Class II like other yogurt products.

### **Yogurt Containing Products Should Be Class II**

Yogurt containing products are fundamentally different than fluid milk in a number of respects. They are produced by only a few plants and are shipped across the U.S., unlike fluid milk. The shelf life of these products averages 30-60 days, far exceeding the shelf life of fluid milk that has not been heat-treated. They have a thicker texture and greater viscosity than fluid milk, and they have a different taste profile than fluid milk. Not surprisingly, none of these products meet the standard of identity of fluid milk.

In supermarkets, they are generally sold next to yogurt, not fluid milk. They are not sold in half gallons or gallons, but rather are in single serving size containers, most if not all of which are hermetically sealed.

Let’s turn to an examination of how these products are used by consumers. In so doing, it is essential to examine if, in fact, these products are “competing for the same consumers” or are in the “competitive sphere of the traditional milk beverages.”

Our member companies will present a variety of consumer data demonstrating that consumers use these products as food. In other words, simply because a product is drinkable does not mean that consumers use the product as a beverage.

Rather, the evidence that our member companies will present will establish that these are food products that are marketed, sold and used as such by consumers. Consumers purchase these

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<sup>8</sup> *Id.* at 9015.

<sup>9</sup> 56 Fed. Reg. 58972, 58991 (November 22, 1991).

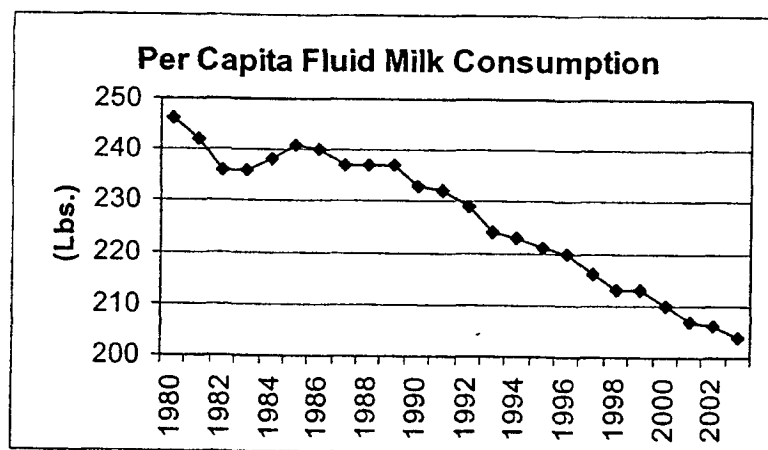
<sup>10</sup> 58 Fed. Reg. at 12657.

yogurt-containing products instead of other food products, not fluid milk. Put another way, these products compete with and are substitutes for other food products, not fluid milk, and they should be classified as such. Because these products neither compete with nor substitute for fluid milk, they should not be Class I products.

Food manufacturers have made yogurt, a food product, more convenient for today's consumers by making it drinkable. That does not mean, however, that these products compete with fluid milk for the same consumers or that dairy producers are somehow being deprived of their fair share of the value from the marketplace. In fact, we believe that efforts to change the fluid milk product definition will end up hurting dairy producers by driving manufacturers to use other ingredients for their products.

### **Can Dairy Compete With Other Food Ingredients and Products?**

Why are we at this hearing today? What are the objectives of the proposed changes? Is it to enhance the volume of class I milk within the Federal Orders? Clearly per capita consumption of fluid milk products has been on a steady decline since the 1980's (see chart). Since 1980 per capita fluid milk consumption has decreased from nearly 250 pounds to 207 pounds in 2003.



It is my opinion that proposals to broaden the class I fluid milk definition to include a wide variety of beverages containing dairy ingredients appear to be an attempt to throw out a regulatory net to see what additional volume could be captured into the ever shrinking Class I pool of milk.

Unfortunately, this attempt to enhance the pool is more likely to reduce the pool long term. The dairy sector is one of, if not the highest, regulated ingredient in the food sector. In terms of new product development, I have witnessed a venture capitalist walk away from a new dairy beverage start-up company due to the complexity and lack of long-term forward pricing for milk.

In the competitive, every changing world of beverages, product developers do not need to use dairy ingredients to manufacture a nutritious beverage. In particular, the soy industry is very aggressive in finding new market opportunities for soy protein. In some cases, soy and milk proteins are being used together in applications that were once considered "dairy only."

Economists can and will debate what the net financial impacts of changing the fluid milk definition with the Federal Orders may be to dairy producers. In my analysis, had all 14.1 billion pounds of Class II producer milk in 2004 been priced at the Class I price during 2004, the producer blend price would have increased by \$0.42 per cwt. I estimate that perhaps 10%, at most, of this volume is used in beverage form, suggesting a net blend impact of less than a nickel.

Again, economists may debate the relevance of a nickel per cwt; however, there can be little debate as to the financial impact to dairy producer from increased demand for dairy products. Take for example, the increased global demand for domestically produced skim milk powder which is a Class IV product. The Class IV price plus a \$0.70 premium establishes the Class II skim milk price. During the first half of 2005, the regulated class II skim price averaged \$7.40 per cwt, \$0.78 higher than the prior year, due to increase demand.

My point is a simple one. Let's create market opportunities for dairy ingredients, not erect barriers to new product development and innovation. According to USDA, "Report to Congress on the National Dairy Promotion and Research Program and the National Fluid Milk Processor Promotion Program," America's dairy farmers and milk processors now spend over \$350 million annually to help drive demand for fluid milk and dairy products. USDA claims to "strongly support national commodity research and promotion initiatives such as these, which provide industry with important self-help tools for the development, maintenance, and expansion of domestic and international markets for dairy products."

As an economist, I see the industry trying to drive demand through research, education and promotion while the regulatory environment hinders the growth in supply of new dairy products.

Perhaps the objective of those seeking to expand the Class I fluid milk definition is to create an equal playing field. Some Federal orders may interpret classification differently than others. Some in the industry may perceive that the growth in non-class I beverages that contain dairy ingredients has come at the expense of the traditional higher priced class fluid milk sector.

It is my opinion as an economist and as a consumer that these yogurt containing products and fluid milk are not substitutes. I purchase six gallons of milk per week and at least one eight-pack of yogurt containing products for a family of three adults and two children. My milk purchases have been stable over the last decade. However, the addition of these new yogurt containing products has only occurred in the past couple years.

In our home, milk is consumed as a beverage at meals, an ingredient for cereals and baking and a compliment product with cookies. These yogurt-containing products, in contrast, are a mid-day snack. As a consumer, I like the convenience of the product. I can grab it and go. It packs a lot of nutrition without a lot of calories. I don't feel like I need something sweet to compliment the product. In other words, I don't dunk my Oreos in it. It's a stand-alone product, and its just two weight watchers points.

For those who are concerned about creating a level playing field in the marketplace, I would point out that the state of California produces one-fifth of the nation's milk supply and plays by different rules. Yogurt drinks in California are Class II and there is no minimum yogurt requirement. UHT and Ultra pasteurized milk products are also Class II if sold outside of California.

The fact that food manufacturers can create a variety of products that are drinkable, some of which are Class I while others are Class II, does not mean that there is disorderly marketing. It means that companies are behaving exactly as they should, trying to be as efficient and innovative as possible to create new products for today's consumers. Setting up a new fluid milk product definition will just disrupt the market and drive companies away from dairy ingredients. Companies will also work to minimize the cost of the remaining dairy ingredients that are absolutely necessary for their products.

The Federal Orders regulate less producer milk today than in 2000. Historically the Federal Orders regulated 70 percent of nation's milk supply. In 2004, the Federal Orders regulated just 60% of producer milk, down from 65% in 2003. As a result, there is a greater opportunity to produce products in unregulated areas that tend to be subject to less regulation. It is my opinion that any action that broadens the Class I fluid milk definition or the application thereof will lead to a shift in the production of these products to the West whenever possible.

I would also assert that the level of complexity and cost to the Orders as it traces every dairy component brought on by broadening the Class I definition does not merit the potential and questionable increased revenue to producers.

## **Conclusion**

We believe that the evidence presented at this hearing conclusively demonstrates that these yogurt-containing products are food products and should be classified as such. They are marketed as food. They are used by consumers as food, and they compete with other food products, not fluid milk. USDA cannot simply ignore this evidence by asserting, as it has in the past, that they should be Class I beverages simply because they are drinkable rather than spoonable. This simplistic notion does not overcome the actual evidence we have submitted into the record, and it is upon this record that USDA must base its decision.

Thank you for the opportunity to testify today.